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Connecting Climate Change and the Law

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EC Proposes Net-Zero Industry Act to Spur Green Technology Investment

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The European Commission last month announced a proposed **Net-Zero Industry Act** designed to drive the investment in and the growth of the clean technology manufacturing sector. The proposed Act is part of the **Green Deal Industrial Plan announced in February**.

The **animating goal** of the Net-Zero Industry Act is to create a hospitable regulatory and investment environment for the development of priority net-zero technologies, with the ultimate aim of having the EU's net-zero technologies manufacturing capacity reach at least 40% of the EU's overall needs by 2030.

The Act's objectives include:

Expedited permitting. The Act aims to fast-track construction of priority net-zero technology projects that will contribute to the EU's decarbonization objectives by improving the "enabling" conditions for investment, and reducing regulatory and administrative "red tape." The proposal mandates a "one-stop shop" approach requiring member states to designate a single responsible administrative agency; online access to permitting resources through that agency; and simplified permit-granting processes and accelerated permitting timelines.

Prioritized "strategic" net-zero technologies. The Act identifies priority or "strategic" technologies as those that: 1) will make a significant contribution to the "Fit-for-55" target of reducing net greenhouse gas emissions by at least 55% (relative to 1990 levels) by 2030; 2) operate in markets that have achieved a required level of technological readiness and maturity; and 3) in the case of components or parts, would benefit from scaled up manufacturing capacity in the form of increasing supply chain security in situations where the EU heavily or increasingly depends on imports, particularly from a single country.

These designated priority technologies include solar, wind, batteries and storage, heat pumps and geothermal energy, electrolyzers and fuel cells, biogas/biomethane, carbon capture, utilization and storage, and grid technologies, as well as their corresponding main upstream components (for example, ingots, wafers and solar cells for solar modules; towers and blades for wind turbines). The draft proposal also provides that these strategic projects should be given priority status and urgent treatment in all judicial and dispute resolution processes.

Accelerating carbon capture and storage EU-wide. The Act also would prioritize projects focused on accelerating CO2 capture and storage, including identifying and enhancing the availability of storage sites EU-wide. The EC has set an objective of annual 50Mt injection capacity across the bloc by 2030. Notably, the proposed legislation contemplates significant funding contributions in the development of these projects from oil and gas companies operating in the EU on a *pro rata* basis relative to their oil and natural gas production.

Easier access to private and public investment funding. The EC's proposal sets forth measures to enhance both public and private investment in and financing of strategic net-zero technology projects, including working with the European Investment Bank and other partners in the InvestEU Program to develop public-private financing programs, and encouraging the deployment of state aid under new amendments to the state aid rules. In its **"Questions and Answers"** document, the EC also points to a number of EU funding programs available to fund investments in net-zero technology projects. The proposal also calls for the development of a European Sovereignty Fund to meet investment needs across the EU.

Building a skilled workforce. The Act introduces several measures and mandates for member states, as well as providing €5.5 million in seed funding for the establishment of EU Net-Zero Industry Academies. The expectation is that member states, industry and other stakeholders will be involved in the design of courses for—and funding of—these training entities to re-skill and up-skill workers. The proposal contemplates that the Net-Zero Europe Platform, a central information and coordination resource for Member States and the EC around the implementation of the Act, will be essential to the establishment of the academies, as well as facilitating mobility of skilled workers within the EU, and the matching of skill sets and jobs.

Setting up regulatory sandboxes to fostering innovation. The Act proposes a rubric for members states to set up "regulatory sandboxes"—temporary regulatory frameworks that can be created at the request of companies developing innovative net-zero technologies that allow development and testing of the technologies before their deployment into the market. Companies must comply with specific, yet-to-be decided eligibility and selection criteria, and small- and medium-sized enterprises will be given priority access to the sandboxes. In the spirit of cross-border cooperation, member states are expected to coordinate regulatory activities and share relevant information.

Taking the Temperature: The development of green technologies is central to the ongoing global efforts to develop and source capital to pay for investment in clean technology—with the United States, Japan, India, China, Canada and the UK all having recently undertaken initiatives in this area. As we observed in our discussion of the European Green Deal Industrial Plan, the Net-Zero Industrial Act is, at least in part, a response to the U.S. Inflation Reduction Act (IRA), which included approximately $370 billion in climate and energy-related provisions, $121 billion of which are in the form of investment and production tax credits.

Slow permitting processes in many Member States, lack of transparency and coordination, and inherent differences in resources, have all been identified as major obstacles to EU-wide efforts to achieve a green transition. As noted in the preamble to the Act, the EU is currently a net importer of net-zero energy technologies, with the

majority of imports coming from China. Even in sectors where EU industry is strong, such as wind turbines and heat pumps, the trade balance is deteriorating and EU producers face rising energy and input costs. The Act and the companion Critical Raw Materials Act (aimed at identifying and ensuring the availability of raw materials necessary in the manufacture of net-zero technologies) aim to address import-heavy supply chains and the need for the EU to reduce its reliance on imports, in particular in sectors critical to the bloc's ability to reach its net-zero emissions goals on schedule. Both legislative proposals are widely viewed as critical to accelerating the EU's efforts not only to compete in the race for technological advancement in green technology, but also to meet the bloc's ambitious targets for decarbonization.

As we have previously noted, the role of nuclear energy in the green transition remains controversial. The Act does not include nuclear energy-related projects on its list of strategic net-zero strategic projects. However, small modular nuclear reactors and nuclear plants with limited waste are included as second-tier priority technologies, which does allow them the benefits of general incentives such as streamlined permitting procedures.

Study Finds Companies Increasingly Disclosing ESG Information Voluntarily

May 2, 2023

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A **recent academic study** covering the period 2010-2021 has found that many companies in the S&P500 currently are providing disclosure on ESG issues, and in the absence of mandated disclosure rules, do so on a voluntary basis. During the time period studied, the percentage of firms releasing voluntary ESG disclosure reports jumped from 35% to 86%. The Study's authors found that "despite the rapid growth in the percentage of reporting firms, growth in the length of these reports was modest," with "significant variation across sectors." They also concluded that "firms with more negative ESG-related incidents and those with shorter 10-K filings are more likely to publish an ESG report, suggesting that these firms do so in response to negative attention and these disclosures serve to augment what is disclosed in regulatory filings."

The Study drew a potential link between the issuance of guidance by the Sustainability Accounting Standards Board and the amount of ESG-related information disclosed. According to the Study's authors, "we find statistically and economically meaningful evidence that firms increased their disclosure of material ESG information after the release of SASB standards, with the proportion of material information increasing by an average of 11.0% after the standards. These findings are among the first to suggest that well-defined voluntary standards and guidance can help improve ESG disclosures and should be of interest to investors and regulators." The **SASB** is a non-profit organization that develops and disseminates standards for the disclosure of sustainability issues material to the financial performance of companies across 77 industries.

"These results provide evidence that standards, even voluntary ones, can serve as powerful guidance when a large sample of firms chooses voluntary disclosure in the absence of regulation. The analysis also suggests that disclosure leaders (i.e., [Industry Working Group (IWG)] firms) can learn while doing, while other firms may be equally quick to respond once standards are known," the Study's authors **stated in a post** about their study on the Harvard Law School Forum on Corporate Governance.

Taking the Temperature: As we have previously discussed, ESG disclosures have become a hotly contested political issue in the U.S. In response to the SEC's proposed climate disclosure rule, certain Republican members of Congress, led by the Chair of the

House Financial Services Committee, Patrick McHenry, and Oversight and Investigations Subcommittee Chair Bill Huizenga, established a nine-person Republican ESG Working Group to "combat the threat to our capital markets posed by those on the far-left pushing environmental, social, and governance (ESG) proposals." On the other side of the aisle, the Congressional Sustainable Investment Caucus, a Democrat-led initiative, was formed to "bring together Members of Congress with experts to better understand sustainable investing and inform policy making that provides investor protections and transparency of information to market participants."

In the meantime, attempts to enact federal legislation covering ESG disclosures have not advanced. For instance, the Corporate Governance Improvement and Investor Protection Act (H.R. 1187) was passed by the U.S. House of Representatives in June 2021 but stalled in the Senate after being referred to the Committee on Banking, Housing and Urban Affairs. The bill would have required publicly traded companies to periodically disclose information related to, among other things, ESG performance metrics. It would also have established a Sustainable Finance Advisory Committee to recommend policies to the SEC that facilitate the flow of capital toward environmentally sustainable investments.

As we have reported, European initiatives relating to sustainable reporting continue to move forward, including via the European Sustainability Reporting Standards. Even in the U.S., notwithstanding the partisan nature of the political discussion around ESG, most large companies are preparing to comply with the SEC's proposed climate disclosure rule even though it is not final, although many business leaders have expressed concern over having the resources required to do so.

What's in a Name? ASEAN Taxonomy Version 2 Released

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On March 27, the Association of Southeast Asian Nations (ASEAN) Taxonomy Board (ATB), representing ASEAN finance sectoral bodies, released **Version 2** of the ASEAN Taxonomy for Sustainable Finance. This follows **Version 1,** which was released in November 2021. The Taxonomy is "designed to enable a just transition towards sustainable finance adoption by ASEAN Member States" by articulating underlying principles to "harmonise the classification of sustainable activities and assets across ASEAN."

The ASEAN Taxonomy is based on four Environmental Objectives (EOs): Climate Change Mitigation, Climate Change Adaptation, Protection of Healthy Ecosystems and Biodiversity, and Resource Resilience and the Transition to a Circular Economy. "To be classified under the ASEAN Taxonomy, any Activity must demonstrate that it contributes to at least one of these EOs and does not have any adverse effects to other EOs" (i.e., a "do no harm" approach). In addition to satisfying DNH, to be classified as sustainable an activity also must satisfy Remedial Measures to Transition, "which ensures that any significant harm is either removed or rendered insignificant," and a Social Aspects criteria, which "focuses on social aspects that could be harmed by an Activity, such as human rights, labour rights, and impact on people living close to the investments."

To promote achieving these EOs, the Taxonomy articulates five core principles and two assessment approaches, the Foundation Framework comprising "detailed methodologies for assessing economic activities," and a more granular Plus Standard which applies to six "Focus Sectors" and three "Enabling Sectors" that have been identified as particularly important for sustainable development in the region."

Activities are classified as "Green," "Amber" or "Red." To be classified as "Green" or "Amber," an activity "must result in a positive benefit to one or more environmental objectives; or create[s] some form of utility whilst displacing another provider of that utility which detracts from an environmental objective." A "Red" classification means that an activity is "not aligned with the ASEAN Taxonomy." Guiding questions are included for each environmental activity to help assess whether an activity is "Green," "Amber" or "Red." The Taxonomy utilizes Technical Screening Criteria to assess and classify activities according to this stoplight approach.

Phasing out Coal

The Taxonomy addresses the region's specific circumstances and the initiatives already being developed that aim to "promote the phase-out of coal-fired power plants in Asia." **Version 2** introduces coal phase-out as an activity which may be classified as "Green" or "Amber" under the Plus Standard framework – "a global first for a regional taxonomy."

The ATB will now hold targeted consultations with key stakeholders on the Plus Standard and the proposed technical screening criteria for the energy sector. The goal is to finalize these standards in early 2024. Subsequent versions of the ASEAN Taxonomy will expand the Plus Standard and criteria to cover the other five focus sectors (agriculture, forestry and fishing; manufacturing; transportation and storage; water supply, sewerage and waste management; and construction and real estate). The ASEAN Taxonomy is currently scheduled to be finalized by 2025.

Taking the Temperature: The tiered-framework of the ASEAN Taxonomy has been designed to align with other key taxonomies such as the EU Taxonomy and Singapore Taxonomy. The traffic light classification system is similar to the approach adopted by the Singapore Taxonomy, both of which recognize an "Amber" classification of activities, which are those that are either transitioning towards "Green" within a certain time frame or enabling significant emissions reductions in the short term. The taxonomy proposal by Canada's Department of Finance likewise recognizes a transition classification, whereas the proposed UK and enacted EU taxonomies do not have that category. While seemingly minor, these differences in taxonomies across countries is potentially significant in terms of capital allocation. Taxonomies are essential in allowing investors and companies to understand what industries, businesses and projects will be considered sustainable. The development of regional taxonomies with varying approaches and rubrics underscores not only the difficulty in defining a sustainable activity or project, but also increases the regulatory and practical burdens investors and financial market participants will likely face in making investment decisions.

Biden Administration Pledges $500 Million to the Amazon Fund

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On April 20, during a meeting of the Major Economies Forum on Energy and Climate (MEF), **President Biden pledged $500 million to the Amazon Fund**, Brazil's signature fund set up to raise donations for investments to prevent, monitor and combat deforestation in the Brazilian Amazon region. If approved by Congress, the pledge would make the U.S. the largest donor to the Amazon Fund after Norway, which has already donated more than $1.2 billion.

The **Amazon Fund** was established by Brazil in 2008 during President Lula's first term in office. Activities of the fund were suspended in 2019 during the tenure of the previous President, Jair Bolsonaro. We have **previously reported** that since taking office in January President Lula has embarked on an ambitious environmental agenda vowing to revitalize federal environmental protection agencies to curb deforestation in the Amazon. In January, we covered the **first significant environmental enforcement activity** carried out by the new administration. Both Lula and his Minister of the Environment, Marina Silva, have been active in **courting international investment partners** in recent months. This included a state visit to the White House where Lula and Silva met with President Biden and his Climate Envoy, John Kerry, to discuss U.S. participation in the Amazon Fund.

Ending deforestation in the Amazon and other critical forests is one of **four key priorities discussed during the MEF meeting**. The other priorities are: decarbonization; tackling potent, non-CO2 climate pollutants; and advancing carbon management. During the meeting, President Biden also pledged $1 billion to the Green Climate Fund, a program led by the United Nations to help developing countries become more resilient to climate change and transition to clean energy sources.

Taking the Temperature: President Biden's pledge is a significant coup for the Lula administration and comes at a time when key economies are increasing efforts to combat the climate crisis and fund environmental protection initiatives focused on deforestation. However, the pledge to the Amazon Fund will still require approval from Congress, which could prove challenging. We have written extensively on the evolving U.S. landscape of partisan divisions over climate-related policy. In 2021 the Biden administration pledged to work with Congress to quadruple the country's climate support for developing countries to $11.4 billion each year by 2024; last year, only $1 billion was approved in order to help developing countries combat climate change.

Following the announcement of the pledge, President Biden also was criticized for not being focused enough on the needs of the U.S. Forest Service, whose chief testified that more funding is required to manage forests in the U.S. In Brazil, there are also questions

on the Brazilian government's capacity to address deforestation. Despite Lula's commitment to end Amazonian deforestation by 2030, deforestation rates are still rising.